VOIDING VOIDABILITY

RETHINKING RESCISSION OF INSURANCE POLICIES UNDER OHIO LAW

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One of the principle ways insurers evaluate the risks posed by their insureds and assess the likelihood of potential claims when considering whether to issue a policy and how to price that policy is by means of insurance applications and traditional underwriting of those risks. Relying on representations made by their potential insureds, insurers can utilize traditional underwriting methods to try and set out both the extent of coverages to be offered as well the price of such coverage. Consequently, and to ensure the candor of the insureds' responses, insurers are entitled to rescind the policies issued when insureds intentionally make material misrepresentations on their applications.

That is not to say that all states allow rescission under identical circumstances. For instance, under Pennsylvania law, an insurance policy is void *ab initio*, meaning an insurer can rescind the policy altogether even after a claim has been made against the insured, only where "the insurer can establish that the insured knowingly or in bad faith made a false representation and that the misrepresentation was material to the risk being insured." *Associated Elec. & Gas Ins. Servs., Ltd. v. Rigas*, 382 F. Supp. 2d 685, 690 (E.D. Pa. 2004). In California, on the other hand, "the rule in insurance cases is that a material misrepresentation or concealment in an insurance application, whether intentional or unintentional, entitles the insurer to rescind the insurance policy *ab initio*." *W. Coast Life Ins. Co. v. Ward*, 132 Cal.App.4th 181, 186–87, 33 Cal. Rptr.3d 319, 323 (Cal.App.2005).

Despite these variations, most states agree that where an insured intentionally makes material, false misrepresentations in an application for insurance, the insurer is entitled to rescind coverage, even after a claim is made under the policy. *See also, e.g., Haynes v. Missouri Property Ins. Placement Facility*, 641 S.W.2d 497, 499 (Mo.App.1982) ("A representation in an application for insurance, which is not in the form of a warranty or incorporated in the policy itself, must not only be false, but also material to the risk in order for the insurer to avoid its policy." — applying Missouri law); *Encompass Home & Auto Ins. Co. v. Harris*, 2013 WL 6095496, *4 (Nov. 19, 2013) ("In determining whether an insurer may validly rescind a policy, the Court must first decide whether a misrepresentation occurred, and if so, whether the misrepresentation is material to the risk assumed by the insurer." — applying Maryland law).

But in Ohio, an insured can make fraudulent, material misrepresentations on an application for insurance, and, so long as the insurer does not discover the fraud until after the insured "incurs liability," the insurer is not permitted to rescind coverage so long as the misrepresentation was not incorporated into the insurance policy as a "warranty." As explained by one Ohio court, "[false] representation[s], standing alone, do[] not render the policy void *ab initio* and *may not be used to avoid liability arising under the policy after such liability has been incurred*." *Fifth Third Mortg. Co.*, citing *Allstate Ins. Co. v. Boggs*, 27 Ohio St.2d 216, 271 N.E.2d 855, 857 (1971) (emphasis added).

This unintuitive result is because of a distinction specific to Ohio insurance law between warranties and misstatements on an insurance application. As articulated in *Allstate Ins. Co. v. Boggs*, 27 Ohio St.2d 216, 271 N.E.2d 855, a misrepresentation is considered a warranty only where (1) "the misstatement plainly appears on the Policy or is plainly incorporated into the Policy," *and* (2) "there [is] a plain warning that a misstatement as to the warranty will render the policy void from its inception." *Nationwide Mut. Fire Ins. Co. v. Pusser*, 7th Dist. No. 17 MA 0117, 2018-Ohio-2781, 115 N.E.3d 915, ¶¶ 25, 27. Thus, where a fraudulent misstatement in an application is either not incorporated into the policy itself, or where the policy does not include a warning that a fraudulent misstatement will render the policy void *ab initio*, such a policy is prospectively void*able*, but an insurer cannot rescind the policy once the insured has incurred liability. *See, e.g., Goodman v. Medmarc Ins.*, 8th Dist. No. 97969, 2012-Ohio-4061, 977 N.E.2d 128, ¶ 16 ("If the misstatement constitutes a representation, the policy is voidable if the misstatement is made fraudulently and the fact is material to the risk. But the policy is not void *ab initio*."), *citing Boggs*, 27 Ohio St.2d 216, 271 N.E.2d 855 at 857.

Ohio law is unique in this regard. *See* 44 Am. Jur. 2d Insurance § 1013 (only citing Ohio cases for the proposition that in some jurisdictions "a misrepresentation may not be used to avoid liability arising under a voidable policy after such liability has been incurred."); P.L. Bruner & P.J. O'Connor, Jr., On Construction Law, § 11:108 (same).

A recent example of Ohio's approach to rescission of insurance policies highlights its underlying unfairness. In *Goodman v. Medmarc Ins.*, a lawyer had previously failed to file an appeal for his client and subsequently agreed to a refund of legal fees, which was memorialized in an "Appeal Resolution" agreement. 977 N.E.2d 128, ¶¶ 2-4. The lawyer later applied for liability insurance and checked "no" on the application regarding possible claims or circumstances that could be expected to give rise to claims. *Id.* at ¶ 6. Later, when the former client sued for legal malpractice during the policy period, the insurer sought to rescind the policy on the grounds that

the lawyer's failure to answer "yes" to the question "whether he was aware of an act or omission that might reasonably be expected to be the basis of a claim," rendered the policy void *ab initio*. *Id.* at ¶ 16. On appeal, the court upheld the trial court's finding that the insurer had a duty to defend and indemnify. Following *Boggs*, the court held that even though the policy incorporated the fraudulent misrepresentations into the policy and deemed them material, it did not specifically warn that the policy would be void *ab initio*. *Id.* at ¶ 23. Acknowledging that an insurer may *cancel* a voidable policy, the court held that under Ohio law it could not do so here because there was a claim already made. *Id.*, citing Boggs, 27 Ohio St.2d 216, 271 N.E.2d at 857. Despite the fact that the insured — who knew that there were potential material claims against him — intentionally failed to disclose those claims on his application, the insured could not avoid liability.

Ohio should consider abandoning the above-described approach and follow the lead of other jurisdictions that allow rescission so long as a potential insured intentionally makes fraudulent, material, misrepresentations on an insurance application. Ohio's current approach incentivizes insureds to make material misrepresentations so long as those representations are not explicitly incorporated into the policy or the policy does not explicitly warn that misrepresentations will void the policy *ab initio*. Moreover, Ohio's approach makes it that much more difficult for insurers to evaluate the risks they are assuming when issuing insurance policies, and to price insurance for those risks, ultimately increasing overall premiums for all insureds. Finally, there is no justifiable reason why insurance policies should be treated differently than any other contract, for which rescission is available so long as "(1) [] there was actual or implied representations of material matters of fact, (2) [] such representations were false, (3) [] such representations were made by one party to the other with knowledge of their falsity, (4) [] they were made with intent to mislead a party to rely thereon, and (5) [] such party relied on such representations with a right to rely thereon." *Cross v. Ledford*, 161 Ohio St. 469, 475, 120 N.E.2d 118, 122 (1954). This five-part, trans-substantive test properly balances the rights of the insured to the coverage purchased, and the rights of the insurer to rescind coverage from insureds who fraudulently misrepresent the risks they pose.

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